

## **Subcommittee on Financial Reform--Recommendations**

Proposed Charter Language on the Chief Financial Officer, Audit Committee and City Internal Auditor, Prepared for Submission to the Full Committee by Lisa Briggs and James Ingram

Pursuant to the request of the Subcommittee, staff has prepared this report for forwarding to the San Diego Charter Review Committee.

The Subcommittee made three recommendations for proposed changes to the Charter covering the issues of the establishment of an Office of Chief Financial Officer, an Audit Committee and an Office of City Internal Auditor. The Subcommittee adopted each of these recommendations by a separate motion. The Subcommittee approved the CFO recommendation unanimously (July 27, 2007). The Subcommittee approved the creation of an Audit Committee unanimously (August 10, 2007). A majority of Subcommittee members approved the creation of the position of Internal Auditor, but that recommendation was not approved unanimously (August 10, 2007).

### **OFFICE OF CHIEF FINANCIAL OFFICER**

#### **Current Language**

##### **SECTION 39. CITY AUDITOR AND COMPTROLLER.**

The City Auditor and Comptroller shall be elected by the Council for an indefinite term and shall serve until his successor is elected and qualified. The City Auditor and Comptroller shall be the chief fiscal officer of the City. He shall exercise supervision over all accounts, and accounts shall be kept showing the financial transactions of all Departments of the City upon forms prescribed by him and approved by the City Manager and the Council. He shall submit to the City Manager and to the Council at least monthly a summary statement of revenues and expenses for the preceding accounting period, detailed as to appropriations and funds in such manner as to show the exact financial condition of the City and of each Department, Division and office thereof. No contract, agreement, or other obligation for the expenditure of public funds shall be entered into by any officer of the City and no such contract shall be valid unless the Auditor and Comptroller shall certify in writing that there has been made an appropriation to cover the expenditure and that there remains a sufficient balance to meet the demand thereof. He shall perform the duties imposed upon City Auditors and Comptrollers by the laws of the State of California, and such other duties as may be imposed upon him by ordinances of the Council, but nothing shall prevent the Council from transferring to other officers matters in charge of the City Auditor and Comptroller which do not relate directly to the finances of the City. He shall prepare and submit to the City Manager such information as shall be required by the City Manager for the preparation of an annual budget. He shall appoint his subordinates subject to the Civil Service provisions of this Charter.

##### **SECTION 45. CITY TREASURER.**

The Manager shall appoint a Treasurer subject to confirmation by a majority of the members of the Council. He shall perform duties imposed upon City Treasurers by general law, the City Charter, or ordinances of the Council. The office of the

Treasurer shall consist of the Treasurer and such subordinate officers and employees as shall be authorized by ordinance.

[No alterations are proposed for the rest of Charter section 45, and thus it is not reproduced here.]

**Proposed Language Recommended by Subcommittee**

**SECTION 39. CHIEF FINANCIAL OFFICER.**

The Chief Financial Officer shall be appointed by the City Manager and confirmed by the City Council for an indefinite term and shall serve until his or her successor is appointed and qualified. The Chief Financial Officer shall be the chief fiscal officer of the City. He or she shall exercise supervision over all accounts, and accounts shall be kept showing the financial transactions of all Departments of the City upon forms prescribed by the Chief Financial Officer and approved by the City Manager and the Council. Subject to the direction and supervision of the City Manager, the Chief Financial Officer shall be responsible for the creation of the City's annual budget. He or she shall also be responsible for oversight of the City's financial management, treasury, risk management and debt management functions. He or she shall submit to the City Manager and to the Council at least monthly a summary statement of revenues and expenses for the preceding accounting period, detailed as to appropriations and funds in such manner as to show the exact financial condition of the City and of each Department, Division and office thereof. No contract, agreement, or other obligation for the expenditure of public funds shall be entered into by any officer of the City and no such contract shall be valid unless the Chief Financial Officer shall certify in writing that there has been made an appropriation to cover the expenditure and that there remains a sufficient balance to meet the demand thereof. He or she shall perform the duties imposed upon Chief Financial Officers by the laws of the State of California, and such other duties as may be imposed upon him or her by ordinances of the Council, but nothing shall prevent the City Manager from transferring to other officers matters in charge of the Chief Financial Officer which do not relate directly to the finances of the City. The Chief Financial Officer shall prepare and submit to the City Manager such information as shall be required by the City Manager for the preparation of an annual budget. He or she shall appoint the Chief Financial Officer's subordinates subject to the Civil Service provisions of this Charter.

**SECTION 45. CITY TREASURER.**

The Manager shall appoint the Treasurer. He shall perform duties imposed upon City Treasurers by general law, the City Charter, or ordinances of the Council. The office of the Treasurer shall consist of the Treasurer and such subordinate officers and employees as shall be authorized by ordinance.

**Ballot Language to Adopt Proposed Language**

**SECTION 39. ~~CITY AUDITOR AND COMPTROLLER~~ CHIEF FINANCIAL OFFICER.**

The ~~City Auditor and Comptroller~~ **Chief Financial Officer** shall be ~~elected~~ **appointed by the City Manager and confirmed** by the ~~City~~ Council for an indefinite term and shall serve until his successor is ~~elected~~ **appointed** and qualified. The ~~City Auditor and Comptroller~~ **Chief Financial Officer** shall be the chief fiscal officer of the City. He **or she** shall exercise supervision over all accounts, and accounts shall be kept showing the financial transactions of all Departments of the City upon forms prescribed by ~~him~~ **the Chief Financial Officer** and approved by the City Manager

and the Council. **Subject to the direction and supervision of the City Manager, the Chief Financial Officer shall be responsible for the creation of the City's annual budget. He or she shall also be responsible for oversight of the City's financial management, treasury, risk management and debt management functions.** He ~~or she~~ shall submit to the City Manager and to the Council at least monthly a summary statement of revenues and expenses for the preceding accounting period, detailed as to appropriations and funds in such manner as to show the exact financial condition of the City and of each Department, Division and office thereof. No contract, agreement, or other obligation for the expenditure of public funds shall be entered into by any officer of the City and no such contract shall be valid unless the ~~Auditor and Comptroller~~**Chief Financial Officer** shall certify in writing that there has been made an appropriation to cover the expenditure and that there remains a sufficient balance to meet the demand thereof. He ~~or she~~ shall perform the duties imposed upon ~~City Auditors and Comptrollers~~**Chief Financial Officers** by the laws of the State of California, and such other duties as may be imposed upon him ~~or her~~ by ordinances of the Council, but nothing shall prevent the ~~Council~~**City Manager** from transferring to other officers matters in charge of the ~~City Auditor and Comptroller~~**Chief Financial Officer** which do not relate directly to the finances of the City. ~~He~~**The Chief Financial Officer** shall prepare and submit to the City Manager such information as shall be required by the City Manager for the preparation of an annual budget. He ~~or she~~ shall appoint ~~his~~**the Chief Financial Officer's** subordinates subject to the Civil Service provisions of this Charter.

#### SECTION 45. CITY TREASURER.

The Manager shall appoint ~~at~~**the** Treasurer ~~subject to confirmation by a majority of the members of the Council.~~ He shall perform duties imposed upon City Treasurers by general law, the City Charter, or ordinances of the Council. The office of the Treasurer shall consist of the Treasurer and such subordinate officers and employees as shall be authorized by ordinance.

#### **Staff Addendum**

The City's Auditor and Comptroller is mentioned at present in Charter sections 45, 70, 71, 72, 74, 80, 82, 83, 86, 87, 88, 89, 110, 111, 112, 126 and 144. It may be necessary to add to the above proposed language a sentence indicating that wherever in the Charter the term "Auditor and Comptroller" appears, this should be interpreted to mean "Chief Financial Officer" instead.

As reflected in the proposed language, the CFO is subject to confirmation by the City Council. As part of its deliberations on this issue, the Subcommittee reasoned that, while Council confirmation is appropriate, it does call into question the need for Council confirmation of the positions that report to the CFO under this change. Specifically, this applies to the position of Treasurer. Therefore, in conjunction with this recommendation, the Subcommittee also recommends that Charter section 45 be modified to remove the need for confirmation by the City Council. On July 27, 2007, the Subcommittee included this alteration as part of the motion and its recommendation to be forwarded to the full Committee.

## AUDIT COMMITTEE

### Current Language

The City's present Audit Committee is not provided by any Charter section, but was rather established pursuant to a recommendation of the Kroll Report. Therefore, no current Charter section would be amended by this particular recommendation; rather a new section would be added to Article VII on the City's financial process.

### Proposed Language Recommended by Subcommittee

Article VII

#### **SECTION \_\_. AUDIT COMMITTEE.**

There is hereby created an Independent Audit Committee consisting of five (5) members. The Audit Committee shall be an independent body. To insure its independence, the Audit Committee shall be composed of two (2) members of the City Council for the City of San Diego and three (3) members of the public. One of the two (2) Councilmembers shall serve as the Chair of the Audit Committee. Two (2) of the Public Members shall be nominated by the Mayor and confirmed by the City Council. One (1) of the Public Members shall be appointed solely by the City Council. Public members of the Audit Committee shall possess the independence, experience and technical expertise necessary to carry out the duties of the Audit Committee. This expertise includes but is not limited to basic knowledge of accounting and auditing standards. The public members of the Audit Committee shall serve without compensation for terms of five years until their successors are appointed. Public members of the Audit Committee are limited to two (2) full consecutive terms, with one (1) term intervening before they become eligible for reappointment. The terms of the two (2) appointed City Council members should be arranged to ensure that there is always one member with experience serving on the Audit Committee.

The purpose, membership, resources, procedures and key responsibilities for the Audit Committee are set forth in the City's Municipal Code and the Audit Committee Charter. The composition, rights and duties of the Audit Committee are set forth in full in this Charter Section #####. As such, the provisions of Charter Sections 11.1, 41 and 43 shall not apply to the Audit Committee. All meetings of the Audit Committee shall be noticed and conducted in accordance with the Ralph M. Brown Act.

The purpose of the Audit committee is to assist the City Council in fulfilling its independent, legislative oversight responsibilities related to financial statements, auditing, accounting and related reporting processes and systems of internal controls pertaining to finance, accounting, financial reporting, and business practices and conduct established by City management and the City Council. It provides independent, legislative oversight of the City's accounting and financial reporting processes, financial internal controls, internal financial audit function and audits of the City's financial statements.

The Audit Committee will review the financial reports and other financial information provided by the City, the City's disclosure controls and

procedures, and its internal financial controls; consider the reports of and interact with the City's internal auditor in connection with the internal auditor's performance of an independent internal financial audit function; assume direct responsibility, with appropriate consultation with the Mayor or his designee, for the appointment, compensation, retention and where appropriate, replacement of the outside auditor to the City in preparing or issuing an audit report or related work; oversee the work and independence of the outside auditor, approve all auditing services and permitted non-audit services provided by the outside auditor, and resolve any disagreements between the Mayor and the outside auditor regarding financial reporting.

In carrying out its oversight functions, the Audit Committee shall:

- (a) The Audit Committee, in conjunction with the City Council, shall independently direct and oversee the work of the City's Internal Auditor. The Internal Auditor will report to and be accountable to the Audit Committee and the City Council. The Audit Committee should approve the annual compensation of the Internal Auditor and annual budget of the Office of the Internal Auditor and be responsible for the annual performance review of the Internal Auditor. The Audit Committee shall review audit reports and transmit all final audit reports to the City Council. The Audit Committee shall monitor the follow-up on the findings of audit reports to ensure that corrective action is taken when needed.
- (b) The Audit Committee shall, be responsible for the appointment, compensation, retention and, where appropriate, replacement of any registered public accounting firm selected to be the City's independent auditor for the purposes of preparing or issuing an audit up to and including the City's annual audited financial statements. It shall meet with the independent auditors prior to the audit for each fiscal year to review the planning, staffing and scope of the audit.
- (c) Review, discuss and monitor the City's annual audited financial statements and any periodic financial statements with the City Manager, the City's Internal Auditor and the independent auditors.
- (d) Based on its review and discussions with management and the independent auditors, recommend to the City Council whether the City's audited financial statements should be received by the City Council.
- (e) Review and monitor major changes to the City's auditing and accounting principles and practices as suggested by the independent auditors or management.
- (f) Review, discuss and monitor with the City Manager and the independent auditors the adequacy and effectiveness of the City's internal controls and the effectiveness of the City's disclosure controls and procedures.
- (g) Review, discuss and monitor with the City Manager and the independent auditors:
  - (1) Any material financial or non-financial arrangements that do not appear on the City's financial statements;
  - (2) Any transactions or courses of dealing with parties related to the City that are significant in size or involve terms or other aspects that differ from those that would likely be negotiated

- with independent parties, and that are relevant to an understanding of the City's financial statements;
- (3) Material financial risks that are designated as such by management or the independent auditors.
- (h) Establish procedures for the receipt, retention and treatment of complaints received by the Audit Committee regarding accounting, internal accounting controls or auditing matters; and the confidential, anonymous submission by the City's employees or members of the public of concerns regarding accounting or auditing matters.
  - (i) Obtain, review, discuss and monitor with the independent auditors annually or more often if deemed necessary by the Audit Committee a report by the independent auditors describing the independent auditors' internal quality-control procedures, and any material issues raised by the most recent internal quality control review or peer review of the independent auditors, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the independent auditors, and the steps taken to address those issues.
  - (j) Review the report by the independent auditors concerning all critical accounting policies and practices to be used; alternative treatments of financial information within GAAP that have been discussed with management officials, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditors; and any other material written communications between the independent auditors and the City's management.
  - (k) Review, discuss and monitor with the independent auditors annually or more often if deemed necessary by the Audit Committee, all relationships the independent auditors have with the City in order to evaluate the independent auditors' continued independence, and receive from the independent auditors on an annual basis a written statement regarding the auditors' independence.

The Audit Committee shall have no authority or responsibility to prepare or direct the preparation of the City's financial statements.

#### **Ballot Language to Adopt Proposed Language**

The proposed language would be added as a new section within the present Charter, and thus the bold-faced language offered in the section above would appear in the Sample Ballot as is, if placed before the voters by the City Council.

#### **Staff Addendum**

The adoption of this proposed language does affect one other current Charter section—111. This section presently deals with audits by "independent auditors who are in no way connected with the City" and thus may interact with the Charter language proposed here. Perhaps a sentence may need to be added to the proposed charter amendment, stating that this new section overrides inconsistent provisions of Charter section 111.

## OFFICE OF CITY INTERNAL AUDITOR

### Current Language

There is no current Charter section creating the position exactly as it is being recommended. In effect, the current Charter section 39's provisions for an Auditor and Comptroller are being separated, with a transfer of the Comptroller function to the CFO, while the Internal Auditor and the Audit Committee are authorized to handle the City's Auditing function. Charter section 39 currently provides so minimal a level of detail on the Auditing function that the proposed language can barely be seen as an amendment of that section.

### Proposed Language Recommended by Subcommittee

Article VII

#### **Section \_\_\_\_.** OFFICE OF CITY INTERNAL AUDITOR.

The Office of the City Internal Auditor is hereby established. The Internal Auditor shall be appointed by the City Manager in consultation with the Audit Committee and confirmed by the City Council and shall serve for a term of ten (10) years. The City Internal Auditor may be appointed to two terms. The Internal Auditor shall report to and be accountable to the Audit Committee and the City Council. The Audit Committee by resolution adopted by not less than three quarters of its members, may remove the City Internal Auditor from the office before the expiration of his or her term for misconduct, inefficiency, incompetence, inability or failure to perform the duties of such office or negligence in the performance of such duties, provided that the Audit Committee first states in writing the reasons for such removal and the incumbent is given an opportunity to be heard before the full Council in his or her own defense. The City Council may override the decision of the Audit Committee to remove the City Internal Auditor based on receiving no less than five votes of a City Council comprised of eight members, or six votes of a City Council comprised of nine members, or two-thirds of a total City Council membership. Otherwise, neither the Audit Committee or the Council may remove an incumbent from such office before the expiration of his or her term.

The City Internal Auditor shall have the following powers and duties:

- (a) Prepare an annual Audit Plan to identify the areas of the Organization to be audited. The annual Audit Plan will be based on a formal Risk Assessment of City operations. The Risk Assessment will be performed in accordance with the Professional Practice of Internal Auditing. This Risk Assessment will identify the City's activities, organizational units, or functional processes that have the highest level of inherent risk to be included in the annual Audit Plan for audit coverage.
- (b) Conduct or cause to be conducted an annual audit of internal controls over financial reporting, and post audits of the fiscal transactions and accounts kept by or for the City and its departments, offices and agencies. Such audits shall include but not be limited to the evaluation of key controls over financial reporting, examination and analysis of fiscal procedures and the examination, checking and verification of accounts and expenditures. The audits shall be conducted in accordance with Generally Accepted Government Auditing Standards in conjunction

with the Internal Standards for the Professional Practice of Internal Auditing, and shall include tests of the accounting records and other auditing procedures as the City Internal Auditor may deem necessary under the circumstances. The audits shall include the issuance of suitable reports of examination so the Audit Committee, Council, Chief Financial Officer, and the public will be informed as to the adequacy of the City's internal controls over financial reporting.

- (c) Conduct performance audits, as appropriate of any City department, office or agency. A "performance audit" means a post audit which determines with regard to the purpose, functions and duties of the audited agency all of the following:
  - (1) Whether the audited department, office or agency, is managing or utilizing its resources, including public funds, personnel, property, equipment and space in an economical and efficient manner.
  - (2) Causes of inefficiencies or uneconomical practices, including inadequacies in information management systems, internal and administrative procedures, organizational structure, use of resources, allocation of personnel, purchasing policies and equipment.
  - (3) Whether the purposes and/or functions of the department or agency are being satisfactorily achieved.
  - (4) Whether objectives established by the City Manager, Mayor, Council or other authorizing body are being met.
  - (5) Whether audit recommendations will improve efficiency and effectiveness.
- (d) Conduct special audits and investigations, as requested by the City Manager, Audit Committee, or deemed necessary by the City Internal Auditor. "Special audits" and "investigations" mean assignments of limited scope, intended to determine:
  - (1) The accuracy of information provided to the City Manager, Audit Committee, Council or public.
  - (2) The costs and consequences of recommendations made to the Council.
  - (3) The validity of accusations of material fraud, waste or abuse reported through the City's confidential hotline and other sources.
  - (4) Other information concerning the performance of City Departments, Offices or Agencies as requested by the City Manager or Audit Committee.
- (e) The City Internal Auditor shall have access to, and authority to examine any and all documents including but not limited to books, accounts, internal memoranda, writings and tapes, reports, vouchers, correspondence files, electronic data, and other records, bank accounts, money and other property of any City department, office or agency, whether created by the Charter or otherwise. It is the duty of any officer, employee or agent of the City having control of such records to permit access to, and examination thereof, upon the request of the City Internal Auditor or his or her authorized representative. It is also the duty of any such officer, employee or agent to fully cooperate with, and to make full disclosure of all pertinent information. All City contracts with

consultants, vendors or agencies will be prepared with an adequate audit clause to allow the City Internal Auditor access to the entity's records needed to verify compliance with the terms specified in the contract.

- (f) Prepare and submit to the Audit Committee, at least quarterly, a written report of the City Internal Auditor's activities and findings, together with any recommendations to improve the administration of the City;
- (g) Perform other auditing functions, consistent with other provisions of this Charter, and prepare and submit such other reports, as may be requested by the City Manager, Audit Committee or Council such as but not limited to:
  - (1) Assessing City departments, agencies and vendors compliance with appropriate City, State and Federal policies, procedures, laws, regulations, and contracts.
  - (2) Evaluating if City assets are properly accounted for and safeguarded from losses.
  - (3) Reviewing the City's information technology systems to ensure electronic data is accurately processed and adequately safeguarded.

**Ballot Language to Adopt Proposed Language**

The proposed language would be added as a new section within the present Charter, and thus the bold-faced language offered in the section above would appear in the Sample Ballot as is, if placed before the voters by the City Council.